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In The

Supreme Court of the United States

October Term, 1996

ZANTOP INTERNATIONAL AIRLINES, INC.,

Petitioner,

vs.

REVENUE DIVISION, DEPARTMENT OF TREASURY, STATE OF MICHIGAN,

Respondent.

Petition For Writ Of Certiorari To The Court Of Appeals Of The State Of Michigan

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether, under the Equal Protection Clauses of the United States Constitution, the Michigan Court of Appeals erred in upholding the constitutionality of the preferential treatment of certain instrumentalities of interstate commerce under the Michigan Use Tax Act?

LIST OF PARTIES

The parties to the proceedings below were the same as those mentioned in the present caption.

DISCLOSURE OF CORPORATE AFFILIATIONS OF PETITIONER

Pursuant to Supreme Court Rule 29.6, Petitioner makes the following disclosure:

> Petitioner is not a subsidiary or affiliate of a publicly-owned corporation.

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PETITION FOR WRIT OF CERTIORARI

TO: THE HONORABLE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE UNITED STATES SUPREME COURT.

Petitioner, Zantop International Airlines, Inc. ("Petitioner"), respectfully requests that this Court issue a writ of certiorari to review the decision issued by the Michigan Court of Appeals on May 26, 1995, which decision the Michigan Supreme Court declined to review by order dated September 27, 1996.

OPINIONS BELOW

The Michigan Court of Appeals entered its unpublished opinion cn May 26, 1995. The Michigan Supreme Court issued its unpublished order which did not consider this case on the merits, and which denied Petitioner's application for leave to appeal, on September 27, 1996. Both the Michigan Supreme Court's order and Michigan Court of Appeals' opinion are set forth in the attached Appendix, see App. 7-16.

JURISDICTION

This petition is filed within 90 days of the entry date of the Michigan Supreme Court order of September 27, 1996, which denied Petitioner's application for leave to appeal, 28 U.S.C. § 2101(c). This Court's jurisdiction to consider this petition from the decision of the Michigan Court of Appeals after the Michigan Supreme Court denied Petitioner's application for leave to appeal is invoked under 28 U.S.C. § 1257(a), see *Douglas v. California*, 372 U.S. 353 (1963).

CONSTITUTIONAL, STATUTORY AND REGULATORY PROVISIONS

This case concerns the following constitutional, statutory and administrative provisions: U.S. Const. amend. XIV, § 1; Michigan Const. 1963 art. 1, § 2; Mich. Comp. Laws Ann. §§ 205.94(k) (West 1986 & Supp. 1995) and 205.94(x); and Michigan Department of Treasury Letter Ruling 89-48. Relevant portions of these provisions are printed in the Appendix, see App. 17-20.

STATEMENT OF THE CASE

Michigan's Use Tax Act, 1937 P.A. 94, as amended, Mich. Comp. Laws Ann. § 205.91 *et seq.* (West 1986 & Supp. 1995) (the "UTA"), violates the Equal Protection Clauses of the United States and Michigan Constitutions, in that it discriminates against similarly-situated taxpayers, all of whom engage in interstate commerce. Several of the exemptions from payment of use tax set forth in the UTA relieve certain instrumentalities of interstate commerce – vessels used in the interstate transport of cargo and aircraft used in the regularly scheduled commercial transport of passengers – from the obligation others have to pay the tax. See App. 18. In addition, Respondent in this case, the Michigan Department of Treasury, has issued Letter Ruling 89-48, which exempts rolling stock from application of the UTA. See App. 19. While these instrumentalities of interstate commerce have effectively received a state subsidy in recognition of the favored status bestowed on interstate commerce, not all similarly-situated entities operating in interstate commerce have been accorded the benefit of exemption from payment of use tax. Petitioner, an air cargo carrier operating in interstate commerce, has been unlawfully made to

bear the burden of use tax from which its counterparts in interstate commerce have been relieved.

A. Petitioner and its Interstate Business Activities

Petitioner is a Michigan corporation with its principal office at Willow Run Airport in Ypsilanti, Michigan. During the tax period in controversy (October 1, 1986 through March 31, 1990), Petitioner operated a fleet of aircraft engaged in the interstate and foreign air freight delivery business it conducted between 45 to 50 airports throughout the United States, including Willow Run Airport in Ypsilanti, Michigan. In its interstate freight delivery business, Petitioner is similarly-situated to other forms of interstate business operations that are conducted between Michigan and other states, including those operations that are conducted on the Great Lakes, those that involve rolling stock, and those that entail the transport of passengers and cargo by air carrier.

With respect to the aircraft Petitioner uses in its interstate air freight operations, Petitioner installs parts, identified as "rotable parts," inclusive of engines, compressors and propellers, engine components, compressors and propellers. The rotable parts are not replaced pursuant to a schedule determined by Petitioner; instead, the parts are installed as part of a replacement, repair, rebuild or overhaul schedule mandated by the Federal Aviation Administration ("FAA"). Once installed, the rotable parts become an indistinguishable part of the aircraft Petitioner uses in its interstate air freight operations.

B. The Proceedings Below

1. The Audit

Respondent audited Petitioner and determined that Petitioner was liable for payment of additional Michigan use tax computed with respect to airplane parts installed on aircraft dedicated to service in interstate channels. As a consequence of its audit determination, Respondent issued Bill for Taxes Due (Final Assessment) E763576 for Michigan use tax, penalty and interest totaling $757,275.72.

2. Proceedings in the Michigan Court of Claims

Following Respondent's issuance of the deficiency assessment against Petitioner for the period in controversy, Petitioner paid the assessment under protest, and filed suit in which it requested a refund of unlawfully paid taxes, penalty and interest in the Michigan Court of Claims. Among the challenges Petitioner tendered in its Court of Claims action were those addressed to the constitutionality of Respondent's taxation of Petitioner under the Equal Protection Clauses of the United States and Michigan Constitutions, U.S. Const., Amend. XIV, § 1; Mich. Const. 1963, Art. 1, § 2, and the Commerce Clause of the United States Constitution, Art. I, § 3, cl 8.

In the equal protection segment of its Court of Claims complaint (count III), Petitioner alleged that, in creating selective classifications of instrumentalities of interstate commerce which are exempt from, or are otherwise not subject to, the Michigan UTA, both the Michigan legislature and Respondent abridged Petitioner's right to equal protection of the laws, as guaranteed under both the United States and Michigan Constitutions. The following

statutory and administrative provisions provide the foundation for Petitioner's count III assertions:

- Section 4(k) of the UTA, see App. 18, states that Michigan use tax shall not apply to:

  > A vessel designed for commercial use of registered tonnage of 500 tons or more, when produced upon special order of the purchaser, and bunker and galley fuel, provisions, supplies, maintenance, and repairs for the exclusive use of the vessel of 500 tons or more engaged in interstate commerce.

- Section 4(x) of the UTA, see App. 18, during the taxable period in issue, provided that Michigan use tax shall not apply to:

  > The storage, use, or consumption of any aircraft owned or used by a domestic passenger air carrier operating under certificate issued by the civil aeronautics board pursuant to section 401 of title IV of the federal aviation act of 1958, 49 U.S.C. 1371, if the aircraft is used primarily in the regularly-scheduled commercial transport of passengers.

- Department of Treasury Letter Ruling 89-48, see App. 19, reflects Respondent's position that the UTA does not apply to rolling stock purchased outside of Michigan which is placed in the stream of interstate commerce, until such time as the rolling stock is converted to an intrastate application.

In the Court of Claims action, Petitioner brought a motion for partial summary disposition of count III of its complaint, in which it alleged that there are no genuine issues of material fact, and that it is entitled to judgment as a matter of law on its equal protection claims. The Michigan Court of Claims granted summary disposition

of count III in favor of Petitioner, and issued an opinion and order and partial final judgment reflecting its determination, see App. 1-6. The Court of Claims found that the exemption for vessels set forth in UTA § 4(k) parallels Petitioner's circumstances in that:

> Both Plaintiff and businesses which fall under this exemption are involved in interstate commerce and shipping freight. The main difference between the two, not taking into account superficial differences, is that one utilizes a ship while the other utilizes aircraft. The Court is strained to understand the differences afforded these two modes of interstate commerce that warrant one form to receive use tax relief with respect to "provisions, supplies, maintenance, and repairs" while the other is not. App. 5.

The trial court opined that the scheme adopted by Michigan bespeaks "an arbitrary approach by Defendant as it applies to the taxation of different instrumentalities of interstate commerce in violation of equal protection." App. 6.

3. Proceedings in the Michigan Court of Appeals

Respondent appealed the trial court's decision to the Michigan Court of Appeals; that court, in an unpublished opinion *per curiam* entered on May 26, 1995 subscribed to by only two members of the three-judge panel, reversed the Court of Claims' determination.

The Michigan Court of Appeals applied the rational basis test to Petitioner's equal protection challenge, stating that "[a] rational basis for legislation exists when any set of facts can be reasonably conceived to justify the discrimination," App. 8, and found no equal protection violation in the manner in which Michigan accorded instrumentalities in interstate commerce – other than

Petitioner – exemption under the UTA. According to the Court of Appeals:

> Plaintiff has failed to negate every conceivable basis that might support the § 4(k) exemption. The Legislature could rationally have decided to exempt parts for vessels exceeding five hundred tons from the use tax because of desire to promote that industry to locate in Michigan. App. 9.

In a strong dissent, Judge Batzer acknowledged the validity of the reasoning offered by the trial court, stating that he "too [was] strained to understand the difference" between Petitioner's aircraft engaged in the air transport of freight and other forms of interstate commerce which receive the benefit of Michigan's use tax exemptions. App. 11. As Judge Batzer explained:

> Defendant at argument offered that perhaps airports put a strain on state resources in terms of connecting highways and such. I had thought that there were significant federal subsidies for such highways to alleviate the burden on state resources, but in any event, do not dock facilities for the loading and unloading of waterborne cargo and its accompanying land transportation to its ultimate markets also place such burdens on highways and other infrastructures? As to which places the greater burden would likely, in my view, be measured in cargo tonnage loaded and unloaded – a figure of which this Court knows little – and, with all due deference, was, I suspect, far from the legislative mind.

In the view of the dissenting judge, no rational basis exists for a scheme which fails to accord Petitioner the use tax exemption allowed for similarly-situated operators in interstate commerce:

> A legislative intent to foster the shipping industry is propounded. Perhaps, but why was the

> shipping industry entitled to such state fostering over the interstate air freight industry? Self-evident reasons do not jump out. . . . If there were an explicit legislative finding on these issues, I would defer to any such remotely rational finding. In the absence of such, I can only conclude that when it comes to equal protection in this taxation scheme, the rational basis test gives way to Orwellian analysis, wherein all of the similarly situated are equal, but some of the similarly situated are more equal than others. In my view there is an equal protection violation here. . . .
>
> In the absence of any legislative finding, the proffered "rational basis" for the legislative exemption for the maintenance and repair of ships of 500 tons or more, but not for air freight haulers, strike me not as genuine rational reasons, but as mere pillows held up by defendant to absorb the attack of plaintiff, until plaintiff, in frustration and exhaustion, ultimately submits.
>
> If there is a rational basis for the unequal use tax treatment here, it wholly escapes me. App. 12.

Petitioner unsuccessfully sought a rehearing by the Michigan Court of Appeals' panel, App. 14, and then filed an application for leave to appeal in the Michigan Supreme Court, which that court denied by order dated September 27, 1996, App. 15.

Petitioner submits that the Michigan Court of Appeals majority erred in its derivation of a rational basis for the legislative design in issue here: promotion of businesses that ply their trade in interstate commerce at the expense of this similarly-situated Petitioner, is not a legitimate purpose justifiably advanced in support of discriminatory tax treatment.

REASONS FOR GRANTING THE WRIT

This case presents a fundamental issue, one critical to constitutional jurisprudence: To what extent may a state, in its taxing enactments and pronouncements, disparately tax similarly – situated taxpayers, all of whom conduct business in interstate commerce, so as to purportedly encourage a particular industry (or, more appropriately, a segment of a particular industry) to locate in-state? The decision of the Michigan Court of Appeals' majority endorses Michigan's patently discriminatory taxing scheme, in clear violation of equal protection guarantees found in both the United States and Michigan Constitutions. The statutory and administrative program in issue here represents nothing other than this state's effort to subsidize certain segments of commerce to the express detriment of other segments of the same industry. Plainly, air freight carriers should not be made to bear the burden of a tax that their vessel, rolling stock and passenger aircraft counterparts need not shoulder. This unlawful classification unlawfully places Petitioner and those members of its class at a distinct competitive disadvantage.

The core of this case is directed to the ability of a state to tax some taxpayers within an industry which has favored status in our constitutional tradition, while exempting from taxation other taxpayers within the same industry. While Michigan undoubtedly is equipped with wide latitude in fashioning taxing legislation, it simply does not have the discretion to subject taxpayers – similarly-situated in that they are within the same industry and compete for air freight business in the marketplace – to different tax treatment, on the flimsy premise that a particular industry sub-group should be induced to locate in this state.

Disparate tax treatment of this nature flies in the face of cherished equal protection guarantees set forth in the federal and state constitutions, whether the rational basis test or some intermediate level of scrutiny is invoked under these facts. In many respects, this case is an extension of the numerous decisions issued by this Court which condemn, under Commerce Clause principles, statutory classifications which actually or effectively discriminate among participants in interstate commerce. The Michigan courts have endorsed a discriminatory taxation scheme which must be declared unconstitutional by this Court.

ARGUMENT

I. THE DECISION OF THE MICHIGAN COURT OF APPEALS WHICH UPHELD THE CONSTITUTIONALITY OF CERTAIN PORTIONS OF MICHIGAN'S USE TAX ACT AS WELL AS RESPONDENT'S APPLICATION AND INTERPRETATION OF THE USE TAX PROVISIONS IN THE FACE OF PETITIONER'S EQUAL PROTECTION CHALLENGE IS IN CONFLICT WITH PRIOR DECISIONS OF THIS COURT WHICH PROHIBIT STATES FROM DISCRIMINATING AMONG SIMILARLY-SITUATED TAXPAYERS, AND WHICH REFLECT THIS COURT'S CRITICISM OF ECONOMIC-PROTECTIONIST LEGISLATION.

A. APPLICABLE CONSTITUTIONAL DOCTRINE

1. The Equal Protection Clause forbids arbitrary distinctions in state tax laws.

In exercising their powers to tax, the states are obligated to adhere to a number of federal constitutional dictates. One of these requirements is that the tax, in its

imposition or administration, must not offend the Equal Protection Clause of U.S. Const. amend. XIV, § 1. App. 17. The Equal Protection Clause guards against "arbitrary distinctions" in state taxation schemes, *Williams v. Vermont*, 472 U.S. 14, 22 (1985).

2. While a state legislature may classify, its power to classify is not unfettered.

While the Equal Protection Clause "does not forbid classifications" but instead is designed to keep "governmental decision-makers from treating differently persons who are in all relevant respects alike," *Nordlinger v. Hahn*, 505 U.S. 1 (1992), citing *F S Royster Guano Co. v. Virginia*, 253 U.S. 412, 415 (1920), the constitutional requirement *is* violated when classes are created arbitrarily and are afforded different treatment without appropriate justification.

a. The rational basis test inquires as to whether the offending legislation is reasonably related to a lawful governmental purpose.

As this Court recently had occasion to acknowledge in *Romer v. Evans*, 116 S. Ct. 1620 (1996), the reality of legislative classifications blends with the ideal of the constitutional guarantee of equal protection through application of the rational basis test. In *Romer*, 116 S. Ct. at 1627, Justice Kennedy observed that:

> [t]he Fourteenth Amendment's promise that no person shall be denied the equal protection of the laws must co-exist with the practical necessity that most legislation classifies for one purpose or another, with resulting disadvantage to various groups or persons. *Personnel Administrator of Mass. v. Feeney*, 442 U.S. 256 (1979); *F.S.*

> *Royster Guano Co. v. Virginia*, 253 U.S. 412, 415 (1920). We have attempted to reconcile the principle with the reality by stating that, if a law neither burdens a fundamental right nor targets a suspect class, we will uphold the legislative classification so long as it bears a rational relation to some legitimate end.

The rational basis test examines whether a rational relationship exists between the classification and the object of the legislation. In general, a statute will survive an equal protection challenge if it sets forth a classification rationally related to a legitimate and *identifiable* governmental interest. In ascertaining whether a statute arbitrarily or legitimately falls within the legislative power to classify, however, the Court must consider *the object* of the legislation. ***Even under the "rational basis" test, the Equal Protection Clause is violated if a statute, on its face, creates a "wholly arbitrary" distinction.*** *Williams, supra*. And while, under tenets of statutory interpretation, statutes are presumed constitutional, the presumption of constitutionality is rebuttable and must give way to the preeminent dictates of this Court that absolutely forbid discrimination among similarly-situated taxpayers, and that denounce inequities created by arbitrary and unreasonable classifications which fail to further any legitimate governmental purpose.

In *Romer*, 116 S. Ct. at 1627, this Court addressed the rational basis test at length:

> [E]ven in the ordinary equal protection case calling for the most deferential of standards, we insist on knowing the relation between the classification adopted and the object to be attained. The search for the link between classification and objective gives substance to the Equal Protection Clause; it provides guidance and discipline for the legislature, which is entitled to

know what sorts of laws it can pass; and it marks the limits of our own authority. In the ordinary case, a law will be sustained if it can be said to advance a legitimate government interest, even if the law seems unwise or works to the disadvantage of a particular group, or if the rationale for it seems tenuous. See *New Orleans v. Dukes*, 427 U.S. 297 (1976) (tourism benefits justified classification favoring pushcart vendors of certain longevity); *Williamson v. Lee Optical of Okla., Inc.*, 348 U.S. 483 (1955) (assumed health concerns justified law favoring optometrists over opticians); *Railway Express Agency, Inc. v. New York*, 336 U.S. 106 (1949) (potential traffic hazards justified exemption of vehicles advertising the owner's products from general advertising ban); *Kotch v. Board of River Port Pilot Comm'rs for Port of New Orleans*, 330 U.S. 552 (1947) (licensing scheme that disfavored persons unrelated to current river boat pilots justified by possible efficiency and safety benefits of a closely knit pilotage system). The laws challenged in the cases just cited were narrow enough in scope and grounded in sufficient factual context for us to ascertain that there existed some relation between the classification and the purpose it served. By requiring that the classification bear a rational relationship to an independent and legitimate legislative end, we ensure that classifications are not drawn for the purpose of disadvantaging the group burdened by the law. See *United States Railroad Retirement Bd. v. Fritz*, 449 U.S. 166, 181 (1980) (Stevens, J., concurring) ("If the adverse impact on the disfavored class is an apparent aim of the legislature, its impartiality would be suspect.").

Under what circumstances has legislation been held to lack a rational relationship to legitimate state interests?

In *Romer*, this Court held that the "sheer breadth" of a Colorado constitutional amendment which prohibited statutes, regulations, ordinances, rules and policies barring discrimination based on sexual orientation "is so discontinuous with the reasons offered for it that the amendment seems inexplicable by anything but animus toward the class that it affects." *Romer*, 116 S. Ct. at 1627. In some settings, it is the unusual character of a discriminatory scheme that draws the attention of the Court to ascertain whether equal protection guarantees have been abridged. For example, in *Louisville Gas & Elec. Co. v. Coleman*, 277 U.S. 32, 37-38 (1928), this Court stated that "[d]iscriminations of an unusual character especially suggest careful consideration to determine whether they are obnoxious to the constitutional provision." Accord, *Romer*. Likewise, if a statute is perceived as being outside "our constitutional tradition," *Romer*, at 1628, it may be that equal protection guarantees have been abridged. "A law declaring that in general it shall be more difficult for one group of citizens than for all others to seek aid from the government is itself a denial of equal protection of the laws in the most literal sense. The guaranty of equal protection of the laws is a pledge of the protection of equal laws." *Shinner v. Oklahoma ex rel. Williamson*, 316 U.S. 535, 541 (1942) (quoting *Yick Wo v. Hopkins*, 118 U.S. 356, 369 (1886)). *Romer*, 116 S. Ct. 1628. Similarly, if a review of the conventions that a provision offends discloses that the conventions are venerable, the offending law may not bear a rational relationship to a legitimate governmental purpose. See *Romer*, 116 S. Ct. 1629; *Kadrmas v. Dickinson Public Schools*, 487 U.S. 450, 462 (1988).

b. The peculiar facts of this case suggest that a heightened scrutiny must be undertaken in evaluating Petitioner's equal protection claims.

The state's power to create classifications for taxation purposes has been critically reviewed by this Court on a number of occasions. While this Court, on the one hand, has acknowledged that the rational basis test generally applies to challenges to economic legislation which rest on equal protection grounds, *FCC v. Beach Communications, Inc.*, 508 U.S. 307 (1993), other of this Court's decisions strongly suggest that a more studied inquiry is required in the context of discriminatory state taxing models.

In this vein, *Williams, supra*, exemplifies this Court's determination to adopt a more restrictive standard of review under the traditional "rational basis" test for classifications engendered by state tax legislation. In *Williams*, the Court considered an equal protection challenge brought by persons who, formerly residents of other states, moved to Vermont and were required to pay a special vehicle purchase and use tax to register motor vehicles purchased outside of Vermont for which a sales tax already had been paid at the time of acquisition. The Court found no legitimate purpose furthered by the facially discriminatory exemption, based as it was upon the state of residence of the owner of the motor vehicle at the time of purchase. The Court rejected the analysis offered by the state that the special use tax met the "rational basis" standard because persons using the roads should have the responsibility of paying for the privilege; the Court observed that wholesale adoption of a "user-pays" principle contravenes the merit of an exemption given to persons who, as Vermont residents, purchase

vehicles in other states and pay sales taxes to the state of purchase. Importantly, the Court observed: "To free one group and not the other from the otherwise applicable tax burden violates the Equal Protection Clause," *Williams*, 472 U.S. at 27.

Similar evidence of this Court's concerns with the equal protection implications of discriminatory treatment at the hands of officials charged with tax administration is found in *Allegheny Pittsburgh Coal Co. v. County Comm. of Webster County*, 488 U.S. 336 (1989), in which the Court held that assessment practices which created a dichotomy between assessments for real properties which had been the subject of recent sales, and assessments for properties which had not changed hands, violated the equal protection mandate that a tax be borne equally by persons positioned within the same classification. *Allegheny* also assumes particular importance in the context of this case to the extent that it patently reaffirms the requirement, one also identified in *Allied Stores of Ohio, Inc. v. Bowers*, 358 U.S. 522, 528-529 (1959), that the legislative or administrative body must disclose the existence of an **identifiable** state interest to be served by the complained-of legislation, rule or administrative pronouncement.

Although a statute imposing a tax (or, as here, a provision relieving a person from the obligation to pay a tax) frequently is accorded deference by the courts, *Madden v. Kentucky*, 209 U.S. 83 (1940), this deference does not mean that all constitutional inquiry is foreclosed when the controversy implicates a tax statute. Indeed, in instances in which a tax enactment also invokes other important constitutional considerations, this Court has applied a more stringent level of scrutiny in evaluating

whether the statute offends equal protection considerations. In *Regan v. Taxation With Representation of Washington*, 461 U.S. 540, 548 (1983), for example, the Court, in its analysis of an entity's challenge to the Internal Revenue Service's denial of tax-exempt status under 26 U.S.C. § 501(c)(3) on First Amendment and equal protection grounds, stated that an analytical standard more stringent than the rational basis test would apply if "Congress were to discriminate invidiously in its subsidies in such a way as to ' "ai[m] at the suppression of dangerous ideas." ' "

To be sure, discriminatory application of a tax exemption can represent an infringement upon one or more significant constitutional rights or directives. In *Speiser v. Randall*, 357 U.S. 513, 518 (1958), this Court observed:

> It cannot be gainsaid that a discriminatory denial of a tax exemption for engaging in speech is a limitation on free speech. . . . It is settled that speech can be effectively limited by the exercise of the taxing power. *Grosjean v. American Press Co*, 297 U.S. 233. To deny an exemption to claimants who engage in certain forms of speech is in effect to penalize them for such speech. Its deterrent effect is the same as if the State were to fine them for this speech. The appellees are plainly mistaken in their argument that, because a tax exemption is a "privilege" or "bounty," its denial may not infringe speech. This contention did not prevail before the California courts, which recognized that conditions imposed upon the granting of privileges or gratuities must be "reasonable."

In recognition of the need to undertake more diligent inquiry in instances in which significant constitutional guarantees or protections are interwoven with the challenged tax, this Court, in *Leathers v. Medlock*, 499 U.S. 439,

453 (1991), advocated use of a heightened standard of scrutiny in examining the interplay of a tax enactment "directed at, or [which] presents the danger of suppressing, particular ideas" protected by the First Amendment guarantees.

c. Modern constitutional jurisprudence disapproves of the economic protectionism fostered by the legislative and administrative scheme in issue in this case.

Although not arising in the context of the Equal Protection Clause of U.S. Const. amend. XIV, § 1, a number of other modern decisions of the Court unmistakably disapprove of discriminatory tax provisions which either facially or operatively mirror the state's protective posture toward identifiable segments of commerce: This Court's stance, one which requires the elimination of legislation according favored status to functionally identical business entities, is readily applied in the context of the even-handed treatment dictated by traditional equal protection guarantees.

In one such case, *Bacchus Imports Ltd. v. Dias*, 468 U.S. 263 (1984), this Court, in analyzing a Commerce Clause attack, confirmed that states may not enact tax provisions that have the effect of favoring local businesses over competing interstate entities. According to this Court, just as discriminatory state statutes enacted for protectionist purposes have been struck down as constitutionally abhorrent, statutes disclosing a policy of favoring isolated segments of business at the expense of others, so as to effectively force certain components of interstate business to subsidize a tax-free status enjoyed by others, must be declared invalid. This dismemberment of the

concept of "economic protectionism" in essence means that the state is precluded from creating palpably arbitrary tax-free zones within its borders which favor one form of business operation over another. See also, *American Trucking Associations, Inc. v. Scheiner*, 483 U.S. 266 (1987); *Tyler Pipe Industries, Inc. v. Washington Dep't of Revenue*, 483 U.S. 232 (1987); *New Energy Co. of Indiana v. Limbach*, 486 U.S. 269, 273-274 (1988).

Recently, in *Fulton Corp. v. Faulkner*, 116 S. Ct. 848 (1996), this Court, in addressing a case involving discrimination, albeit in the context of Commerce Clause jurisprudence, invalidated a North Carolina intangibles tax on shares of corporate stock computed in inverse proportion to the corporation's state income tax liability. In rendering its determination, this Court observed that "[i]n its negative aspect, the Commerce Clause 'prohibits economic protectionism – that is, "regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors." ' " *Fulton*, 116 S. Ct. at 853. Although the challenge advanced in *Fulton* was founded on the Commerce Clause – not presently in issue – *Fulton* nevertheless has a direct bearing upon the fulcrum of this case, *i.e.*, whether some rational basis can be advanced for Michigan's discriminatory taxing scheme. The point is this: If, as *Fulton* confirms, a state is precluded under the Commerce Clause from engaging in economic protectionism by enacting legislation or adopting regulations or policies that discriminate against interstate commerce, then the state, in response to an attack on the legislation brought on equal protection grounds, should be hard-pressed to offer that same economic protectionism in satisfaction of the traditional rational basis test.

Finally, this Court, in the context of Commerce Clause jurisprudence, has adopted a "virtually *per se* rule

of invalidity" to provisions that patently discriminate against interstate trade. *Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978). This same rule should be applied in instances where, as here, exemptive provisions set forth in a state taxing enactment patently discriminate against one form of interstate commerce in favor of others.

The circumstances of this case disclose that Michigan has imposed a penalty in the form of a discriminatory denial of a tax exemption to an actor in a protected zone, interstate commerce, such that the result of the discrimination – the placement of a tax on Petitioner in instances in which other instrumentalities of interstate commerce escape payment of the tax – works an impairment or restraint on interstate commerce.

B. CONSTITUTIONAL DOCTRINE APPLIED IN THE CONTEXT OF PETITIONER'S FACTS

Application of these constitutional precepts to the situation at hand amply discloses the propriety of the Court of Claims' ruling, and the invalidity of the analysis undertaken by the two-judge majority of the Court of Appeals.

1. The UTA provisions, considered together with Respondent's administrative position, establish illegitimate and unreasonable classifications, and evidence a discrimination that violates equal protection guarantees.

The legislative enactment in issue here imposes "an excise tax on the use, storage or consumption of tangible personal property brought into the state in interstate commerce, after it has come to rest in this state." *Western Electric Co. v. Dep't of Revenue*, 312 Mich. 582, 596 (1945). The use tax generally is recognized as an enactment that

complements the Michigan sales tax in that it is designed to extend to those purchases not encompassed by the latter enactment. *National Bank of Detroit v. Dep't of Revenue*, 334 Mich. 132, 141 (1952).

The UTA creates classifications of entities operating within interstate commerce which are subject to special statutory exemption. The following exemptions are provided under the UTA and evidence the unconstitutional tax scheme adopted by Michigan: (1) Aircraft owned by a domestic passenger air carrier if used primarily in the regularly scheduled commercial transport of passengers, M.C.L. § 205.94(x); M.S.A. § 7.555(4)(x), App. 18; see also information relating to the legislative history of this provision at App. 21-30; and (2) vessels designed for commercial use of registered tonnage of 500 tons or more, when produced upon special order of the purchaser, and bunker and galley fuel, provisions, supplies, maintenance and repairs for the exclusive use of a vessel of 500 tons or more engaged in interstate commerce, M.C.L. § 205.94(k); M.S.A. § 7.555(4)(k), App. 18; are expressly exempt from payment of the tax. In addition, Respondent, by administrative action, has stated its determination that rolling stock purchased out of state and placed into interstate commerce is not subject to use tax, Department of Treasury Letter Ruling 89-48, App. 19. The Equal Protection Clause does not solely serve as a constitutional limitation upon actions undertaken by legislative bodies, but also exists as a restraint upon actions taken by administrative officials in the exercise of their duties in collecting a tax. *Raymond v. Chicago Union Traction Co*, 207 U.S. 20 (1907).

In the decision it issued in this case, the two-judge majority of the Michigan Court of Appeals opined that the Michigan legislature could rationally have decided to exempt parts for vessels exceeding 500 tons from the use

tax in recognition of its desire to prompt that industry to locate in Michigan, App. 9. The Court apparently viewed rolling stock in the same manner. However, a reading of the Court of Appeals' majority opinion reveals that the court incorrectly presupposed that Petitioner and other cargo carriers were *not* members of the "same class." While the daily activities carried on by these taxpayers may differ to the extent they are conducted in, or on, different media (air v. water v. ground), an appropriate and serious analysis of the question presented must result in a conclusion that boats, aircraft and rolling stock are intrinsically identical to the extent that **all are involved in cargo transportation activities within the channels of interstate commerce.** Viewed from this vantage, it is readily apparent that Petitioner has been improperly targeted for discriminatory treatment by being subjected to taxes not imposed upon identically-situated members of the same class – here, air, water and ground cargo transport businesses. Given its placement within the same class as those industries which have been selected for favorable tax treatment, Petitioner finds itself at a distinct competitive disadvantage, as it is made to pay use tax when others identically situated are exempt.

2. A desire to encourage industry to locate in the state cannot justify discriminatory taxation among members of the same class.

As this Court noted in *Nordlinger*, 505 U.S. at 15, appellate review of an equal protection challenge akin to that advanced in this case requires consideration of whether the discriminatory classification is supported by a reasonable and identifiable governmental objective:

> To be sure, the Equal Protection Clause does not demand for purposes of rational basis review that a legislature or governing decision maker actually articulate at any time the purpose or rationale supporting its classification . . . Nevertheless, this Court's review does require that a purpose may conceivably or 'may reasonably have been the purpose and policy' of the relevant governmental decision maker. *Allied Stores of Ohio, Inc v. Bowers*, 358 U.S. 522, 528-529 (1959). *See also, Schweiker v. Wilson*, 450 U.S. 221, 235 (1981) (classification scheme must 'rationally advance a reasonable and identifiable governmental objective') (emphasis added).

In *Romer*, this Court again stated that there must be a "link" between the classification and the object of the statute. *Romer*, 116 S. Ct. 1627.

The only justification offered by the Michigan Court of Appeals for the discriminatory classification scheme embodied in the UTA was that the Michigan legislature could have decided to exempt parts for certain vessels from use tax because of its "desire to promote that industry to locate in Michigan." The Michigan legislature chose to further this object by imposing different tax burdens upon members of the same industry, in effect subsidizing those businesses eligible for exemption, see *Regan v. Taxation With Representation*, 461 U.S. at 544, in which this Court observed that "[b]oth tax exemptions and tax deductibility are a form of subsidy that is administered through the tax system. A tax exemption has much the same effect as a cash grant to the organization of the amount of tax it would have to pay on its income." This governmental interest does not justify the discrimination among members of the same industry, and clearly does

not provide a "rational basis" for the disputed classification. Indeed, dissenting Court of Appeals Judge Batzer would have ruled – correctly – "that when it comes to equal protection in this taxation scheme, the rational basis test gives way to Orwellian analysis, wherein all of the similarly situated are equal, but some of the similarly situated are more equal than others." App. 12.

The motive behind the legislative and administrative treatment in issue here represents nothing more than an unveiled intent to bestow the favor of tax exemption upon those isolated interest groups which have been able to muster lobbying efforts sufficiently intensive and persuasive to carry the day. This is the very form of economic protectionism to which this Court has heralded an end. Michigan's blatant discriminatory intent is confirmed by the legislative history of the exemption extended to domestic passenger air carriers, M.C.L. § 205.94(x); M.S.A. § 7.555(4)(x), which discloses that the enactment was expressly designed to benefit a single (former) Michigan airline company, see House Legislative Analysis Section, First Analysis to House Bill 5801 (11/20/94), App. 25-26. In specifically removing the burden of the use tax from the shoulders of precisely identified entities operating within interstate commerce by according them the privilege of exemption or exclusion, while continuing to require Petitioner to bear the brunt of the taxing scheme, the Michigan legislature and Respondent have engaged in actions which have violated Petitioner's right to equal protection, *Williams, supra.* Quite simply, the state **cannot** confer favored status to certain areas it believes warrant attention to the exclusion of others which are deserving of the same quantum of recognition, *Leathers, supra.* Moreover, the administrative

treatment disclosed in Letter Ruling 89-48 evidences Respondent's discrimination against aircraft cargo carriers such as Petitioner.

No natural distinguishing characteristics exist between those classifications for which exemptions have been provided and aircraft or their constituent parts used by Petitioner to transport freight. The Court of Claims accurately determined that the state can advance no legitimate purpose served by permitting a use tax exemption for this highly-selective triad of instrumentalities of interstate commerce to the complete and unwarranted exclusion of Petitioner, App. 1-6. This case does **not** concern a situation in which the legislature or administrative official has promulgated different taxing enactments applicable to varied business activities, but instead evinces a heinous division which requires one entity – Petitioner – to bear the full brunt of a taxing enactment while others who, from a factual premise are indistinguishable, are permitted to wholly avoid application **of the same tax.** Because "[t]he Equal Protection Clause . . . protects the individual from state action which selects him out for discriminatory treatment by subjecting him to taxes not imposed on others of the same class" *Allegheny*, 488 U.S. at 345, it is evident that the classification scheme here cannot withstand constitutional scrutiny.

What is the effect, then, of Michigan use tax exemptions which subsidize some forms of interstate commerce to the detriment of others? Certainly, the lack of availability of an exemption to Petitioner has the effect of discriminating against, and of curbing, the extent and effectiveness of Petitioner's interstate operations. If not now, eventually, other forms of interstate commerce will assume a primary role, with the obvious result that some

instrumentalities of interstate commerce, to the extent they are subsidized through Michigan's offering of a use tax exemption, will flourish, while others, like Petitioner's aircraft, will languish. The dormant Commerce Clause reflects Congress' absolute dictate that interstate commerce be permitted to thrive unfettered by states' taxing mechanisms. However, Michigan's exemptive scheme under the UTA – while partially in step with Congressional intent – significantly departs from that intent in failing to accord a like exemption for Petitioner's aircraft for the years in issue in this case.

While nothing in the federal or state constitutions requires that the Michigan legislature confer subsidies on instrumentalities of interstate commerce, a determination on the part of state government to subsidize one actor in interstate commerce requires that the benefits of the same subsidy be awarded to all who similarly operate in interstate channels. That principle of equality long ago was established by this Court in its decision in *Smith v. Cahoon*, 283 U.S. 553 (1931), in which a private carrier for hire mounted an equal protection challenge to a regulatory enactment that exempted transportation carriers engaged in hauling certain types of products from a bonding requirement, but imposed the requirement on other carriers. According to the Court:

> [T]he constitutional guaranty of equal protection of the laws is interposed against discriminations that are entirely arbitrary. In determining what is within the range of discretion and what is arbitrary, regard must be had to the particular subject of the State's action. In the present instance, the regulation as to the giving of a bond or insurance policy to protect the public generally, in order to be sustained, must be deemed to relate

> to the public safety. This is a matter of grave concern as the highways become increasingly crowded with motor vehicles, and we entertain no doubt of the power of the State to insist upon suitable protection for the public against injuries through the operations on its highways of carriers for hire, whether they are common carriers or private carriers. But in establishing such a regulation, there does not appear to be the slightest justification for making a distinction between those who carry for hire farm products, or milk or butter, or fish or oysters, and those who carry for hire bread or sugar, or tea or coffee, or groceries in general, or other useful commodities. So far as the statute was designed to safeguard the public with respect to the use of the highways, we think that the discrimination it makes between the private carriers which are relieved of the necessity of obtaining certificates and giving security, and a carrier such as the appellant, was wholly arbitrary and constituted a violation of the appellant's constitutional right. 'Such a classification is not based on anything having relation to the purpose for which it is made.' *Cahoon*, 283 U.S. at 566-567.

Our constitutional tradition ascribes great value to unrestrained trade among the states. This tradition is sadly diminished when a state accords exemption from taxation to some forms of interstate commerce, but not to others, effectively making some interstate trade more free than others.

The justification for the legislation proffered by the Michigan Court of Appeals is an illegitimate governmental objective and is in conflict with this Court's precedent. While "a state's goal of bringing in new business is legitimate and often admirable," *Metropolitan Life Ins Co.*

v. Ward, 470 U.S. 869, 879 (1985), this purpose cannot be impermissibly discriminatory. In a different context, the Court in *Metropolitan Life* recognized that "the fact that promotion of local industry is a legitimate state interest in the Commerce Clause context, says nothing about its validity under equal protection analysis." *Metropolitan Life*, 470 U.S. at 876, fn 6. In *Metropolitan Life*, this Court observed that its previous decision in *Allied Stores, supra*, did not hold that promoting domestic business by discriminating against foreign businesses is legitimate. Instead, since the foreign and domestic companies involved in that case were not competing to provide warehousing services, granting the former an exemption did not directly affect adversely domestic companies subject to the tax. The situation presented by this case is precisely that about which this Court in *Metropolitan Life* was concerned. Here, the various instrumentalities of interstate commerce which have been granted exempt status directly compete with air cargo transporters such as Petitioner; thus, a legislative enactment and an administrative interpretation which accord exemptions to some members of the class of interstate carriers to the exclusion of one member of that class directly disadvantage the excluded commercial participant.

Although *Metropolitan Life* and *Allied Stores* involved the distinction between domestic and foreign companies, the rationale employed in those cases is equally applicable here. Petitioner is in the cargo transport business and, as such, competes directly with other cargo transport businesses -- be they transport by land, air or sea. The "reasonable" basis for the exemption offered by the Michigan Court of Appeals in its opinion does not justify the discrimination. In *Metropolitan Life*, this Court recognized

that "acceptance of [the state's] contention that promotion of domestic industries is always a legitimate state purpose under equal protection analysis would eviscerate the Equal Protection Clause in this context." 470 U.S. at 882. The state cannot confer favored status upon certain segments of an industry that it believes warrant attention to the exclusion of others in the same industry who are then placed at a distinct competitive disadvantage.

Because no "state of facts reasonably can be conceived that would sustain" the discriminatory tax classification evident in this case, *Allied Stores*, 358 U.S. at 528, the classification in question impermissibly offends the equal protection guarantees provided under federal and state constitutional provisions and cannot be sustained. Further, to the extent that an intermediate or heightened scrutiny is invoked when examining equal protection challenges to legislation or administrative pronouncements that implicate other constitutional considerations – such as the Commerce Clause – the Michigan scheme most certainly fails.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted:

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STATE OF MICHIGAN

COURT OF CLAIMS

ZANTOP INTERNATIONAL AIRLINES, INC.,

Plaintiff,

v

REVENUE DIVISION, DEPARTMENT OF TREASURY, STATE OF MICHIGAN

Defendant.

File No. 91-13365-CM

Hon. Thomas L. Brown

OPINION AND ORDER

Plaintiff in this action moves the Court for summary disposition pursuant to MCR 2.116(C)(10) on Count III of its complaint in that except as to the amount of damages, there is no genuine issue as to any material fact, and the moving party is entitled to judgment as a matter of law.

Plaintiff, a Michigan corporation, operates a fleet of aircraft in the conduct of an interstate and foreign air freight delivery business. In the course of its business, Plaintiff is required by the Federal Aviation Administration (FAA) to replace, repair or rebuild certain parts, referred to as "rotable parts". To comply with the FAA, Plaintiff shipped these "rotable parts" to vendors outside of Michigan for repair during the taxable period in question. When these "rotable parts" were repaired the parts were sent back to Plaintiff who reinstalled them on its aircraft.

In 1990, Defendant conducted a sales and use tax audit on Plaintiff. As a result of this audit, Defendant determined that Plaintiff owed use taxes on these "rotable parts" in the amount of $757,275.72 including interest and penalties.

In Count III of its complaint, Plaintiff alleges that the Michigan Use Tax, 137 PA 94, as amended, MCL 205.91 *et seq;* MSA 7.555(6) *et seq;* violates Plaintiff's right to equal protection of the law as guaranteed by the United States Constitution under the Fourteenth Amendment and the Michigan Constitution of 1963, Article 1, Section 2. Specifically, Plaintiff contends that the legislature's action of creating classifications of modes of interstate commerce which are exempt and Defendant's issuance of a Letter Ruling concerning the exemption of rolling stock, are evidence of its alleged equal protection claim.

The exemptions at issue cited by Plaintiff arise pursuant to MCL 205.94; (k) and (x); MSA 7.555, (4) (k) and (x) which states in pertinent:

> The tax levied shall not apply to:
>
> (k) A vessel designed for commercial use of registered tonnage of 500 tons or more, when produced upon special order of the purchaser, and bunker and galley fuel, provisions, supplies, maintenance, and repairs for exclusive use of a vessel of 500 tons or more engaged in interstate commerce.
>
> (x) The storage, use, or consumption of any aircraft owned or used by a domestic passenger air carrier operating under a certificate issued by the civil aeronautics board pursuant to section 401 of title IV of the federal aviation act of

> 1958, 49 U.S.C. 1371, if the aircraft is used primarily in the regularly scheduled commercial transport of passengers.

Further, the Letter Ruling cited by Plaintiff in support of its position states in pertinent part:

> 89-48. Interstate versus Intrastate Rolling stock.
>
> You inquire regarding the taxability of rolling stock purchased out of state and placed into interstate commerce outside of Michigan. The vehicles subsequently are converted to use in intrastate commerce in Michigan.
>
> * * *
>
> . . . [I]t is the Department's position that rolling stock purchased and placed into interstate commerce in another state but subsequently converted in Michigan is subject to use tax at the time of conversion.

The Michigan Court of Appeals in *American Amusement Company Inc. v Department of Treasury,* 91 Mich App 573; 283 NW2d 800 (1979), addressed the issue of equal protection violations with regards to a state's taxation scheme. The Michigan Court of Appeals quoting an earlier case stated at 577:

> [T]here is a point beyond which the State cannot go without violating the Equal Protection Clause. The state must proceed upon a rational basis and may not resort to a classification that is palpably arbitrary. The rule often has been stated to be that the classification must rest upon some ground of difference having a fair and substantial relation to the object of the legislation . . . That statute may discriminate in favor of a certain class does not render it arbitrary if

> the discrimination is founded upon a reasonable distinction, or difference in state policy.

In applying this rational basis test the Court must determine whether there is a rational relationship between the object of the legislation and the classification. After review of the proofs in this case the Court is of the opinion that there is no rational classification.

The Court agrees with the Defendant's averment as to the exemption applicable to aircraft owned by a domestic airline as set forth by MCL 205.95(x); MSA 7.555(4)(x). Clearly, this exemption only pertains to the storage, use, or consumption of aircraft owned and utilized in the commercial transportation of passengers. There is no mention, either expressly or impliedly, that said exemption applies to parts of the aircraft. In fact, according to the affidavit of Jesse Weaver, Defendant does tax those parts. Moreover, Plaintiff's own aircraft are not subject to taxation under the Michigan Sales or the Michigan Use Tax.

Furthermore, the Court concedes that the subject of the Letter Ruling, that being rolling stock, is remotely similar factually to Plaintiff's situation. The Court takes notice that Letter Rulings are issued by the Department in response to specific questions and fact situations presented by a taxpayer and that they are not to be relied on by other taxpayers. However, Letter Rulings do provide some guidance regarding the Department's position in a given situation. This point is important in the context of this case.

However, the Court finds that the exemption applicable to commercial vessels of 500 tons or more set forth in

MCL 205.94(k); MSA 7.555(4)(k) more closely parallels Plaintiff's situation. Both Plaintiff and businesses which fall under this exemption are involved in interstate commerce and shipping freight. The main difference between the two, not taking into account superficial differences, is that one utilizes a ship while the other utilizes aircraft. The Court is strained to understand the differences afforded these two modes of interstate commerce that warrant one form to receive use tax relief with respect to "provisions, supplies, maintenance, and repairs" while the other is not.

The United States Supreme Court in *Williams v Vermont*, 472 US 14; 105 S Ct 2465; 86 L Ed 2d 11 (1985), quoting an earlier case held at page 19 that "the states have large leeway in making classifications and drawing lines which in their judgment produce reasonable systems of taxation".

In determining whether a particular taxation scheme is rationally based, the Michigan Court of Appeals in *American Amusement* supra, quoting an earlier case discussed the application of the equal protection clause within the context of a state's taxation scheme. The Michigan Court of Appeals held at 577 that the equal protection clause:

> "impose no iron rule of equality, prohibiting the flexibility and variety that are appropriate to reasonable scheme of state taxation. The state may impose different specific taxes upon different trades and professions and may very [sic] the rate of excise upon various products. It is not required to resort to close distinctions or to maintain a precise, scientific uniformity with

reference to composition, use or value. [citation omitted]

The Court finds that when read individually, Plaintiff's averments as to the applicability of the exemptions available under the Michigan Use Tax and the Letter Ruling at issue are weakened by their differences to Plaintiff's situation.

However, it is the opinion of the Court that, when read as a whole the exemptions to the Michigan Use Tax evidence an arbitrary approach by Defendant as it applies to the taxation of different instrumentalities of interstate commerce in violation of equal protection.

Therefore, the Court finds that Plaintiff's allegations in Count III have merit. Thus, Plaintiff's motion for summary disposition as to Count III is GRANTED.

Date: 2-26-92 /s/ Thomas L. Brown
Thomas L. Brown, Circuit Judge

STATE OF MICHIGAN

COURT OF APPEALS

ZANTOP INTERNATIONAL AIRLINES INC.,

Plaintiff-Appellee,

v

DEPARTMENT OF TREASURY,

Defendant-Appellant.

UNPUBLISHED
May 26, 1995

No. 152381
L.C. No. 91-013365

Before: Fitzgerald, P.J., and Brennan, and Batzer,* JJ.

PER CURIAM.

Defendant appeals from an order of summary disposition in favor of plaintiff. We reverse and remand.

Defendant's sole claim on appeal is that the trial court erred in finding that the use tax exemption contained in MCL 205.94(k); MSA 7.555(4)(k), was arbitrary and violated the equal protection clauses of the United States and Michigan Constitutions. We agree.

Equal protection of the law is guaranteed by both the federal and the state constitutions. US Const, Am XIV; Const 1963, art 1, § 2. Both guarantees afford similar protection. *Doe v Dep't of Social Services*, 439 Mich 650,

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* Circuit judge, sitting on the Court of Appeals by assignment.

670-671; 487 NW2d 166 (1992). The equal protection guarantee requires that all persons under similar circumstances be treated alike. *El Souri v Dep't of Social Services,* 429 Mich 203, 207; 414 NW2d 679 (1987). Equal protection does not require that persons in different circumstances be treated the same. *Thompson v Merritt (Amended Opinion),* 192 Mich App 412, 424; 481 NW2d 735 (1991). When a legislative classification is challenged as violative of the equal protection guarantee, the test to determine its validity depends on the kind of classification and the nature of the interest affected. *Id.* at 424-425.

Social and economic legislation is examined under the traditional "rational basis" test. *People v Perlos,* 436 Mich 305, 331; 462 NW2d 310 (1990); *Rouge Parkway Associates v City of Wayne,* 423 Mich 411, 421-422; 377 NW2d 748 (1985). Under the rational basis test, legislation is presumed to be constitutional and must be sustained if the classification is rationally related to a legitimate governmental purpose or interest. *Doe, supra* at 662; *Bissell v Kommareddi,* 202 Mich App 578, 580; 509 NW2d 542 (1993). The burden of proof is on the person attacking the legislation to show that the state failure to tax similarly situated enterprises uniformly was arbitrary, intentional, and knowing rather than a mistake or the result of an inadvertence. *Kellogg Co v Dep't of Treasury,* 204 Mich App 489, 496; 516 NW2d 108 (1994); *Orion Twp v State Tax Commission,* 195 Mich App 13, 17; 489 NW2d 120 (1992). A rational basis for legislation exists when any set of facts can be reasonably conceived to justify the discrimination. *Kellogg, supra* at 496; *Wartella v East Detroit,* 161 Mich App 522, 556; 411 NW2d 751 (1987).

The Use Tax Act, MCL 205.91 *et seq;* MSA 7.555(1) *et seq,* provides in pertinent part for the following exemptions:

> (k) A vessel designed for commercial use of registered tonnage of 500 tons or more, if produced upon special order of the purchaser, and bunker and galley fuel, provisions, supplies, maintenance, and repairs for the exclusive use of a vessel of 500 tons or more engaged in interstate commerce.
>
> * * *
>
> (x) The storage, use, or consumption of any aircraft owned or used by a domestic passenger air carrier operating under a certificate issued by the United States department of transportation pursuant to section 401 of title IV of the federal aviation act of 1958, Public Law 85-726, 49 U.S.C. 1371, if the aircraft is used primarily in the regularly scheduled commercial transport of passengers. [MCL 205.94(k), (x); MSA 7.555(4)(k), (x).]

Despite plaintiff's arguments to the contrary, we are convinced that the legislature's failure to exempt air freight plane parts from the use tax, in a manner consistent with commercial vessels of 500 tons or more, was not a violation of equal protection. Plaintiff has failed to negate every conceivable basis that might support the § 4(k) exemption. The Legislature could rationally have decided to exempt parts for vessels exceeding five hundred tons from the use tax because of desire to promote that industry to locate in Michigan. We would add that our conclusion is not affected by the exemption contained

in § 4(x) because that exemption is limited to the storage, use, or consumption of a domestic passenger aircraft.

Reversed and remanded.

/s/ E. Thomas Fitzgerald
/s/ Thomas J. Brennan

BATZER, J. (dissenting).

Plaintiff Michigan corporation is an interstate and foreign carrier of air cargo. Plaintiff conducts its interstate and foreign air freight delivery business among and between approximately forty-five to fifty airports including Willow Run Airport in Ypsilanti. As an air carrier subject to Federal Aviation Administration Rules and Regulations, plaintiff is required to repair and replace on a periodic basis and schedule specified by the FAA certain critical parts to its aircraft called "rotable parts." These "rotable parts" important to the context of this case include engines, engine components, propellers, and other critical operating parts.

The engines, propellers, and components are periodically removed from plaintiff's aircraft pursuant to FAA maintenance schedules, and sent to repair facilities outside the State of Michigan where they undergo routine and specified repair, replacement, overhaul, and upgrading. When the repair and overhaul are completed, they are returned to plaintiff, reinstalled on the aircraft, and the aircraft are placed back into service hauling air freight.

The State of Michigan imposes a use tax on plaintiff's costs incurred in the repair and replacement of these

"rotable parts" on the theory that plaintiff is using, storing, or consuming the parts in Michigan, separate and apart from its operations in interstate commerce.

On the other hand, the maintenance and repair of vessels of 500 tons or more engaged in interstate on the Great Lakes is exempt from Michigan's use tax to which plaintiff is subject. Plaintiff claims that this different use tax treatment violates its constitutional right to the equal protection of the laws.

In 1990, defendant conducted a sales and use tax audit on plaintiff. As a result of the audit, defendant determined that plaintiff owed use taxes on these "rotable parts" in the amount of $757,275.72, including interest and penalties.

Both plaintiff and business with vessels of 500 tons or more engaged in Great Lakes shipping are involved in interstate commerce and shipping freight. As the trial judge observed in his well-considered opinion below:

> The main different between the two, not taking into account superficial differences, is that one utilizes a ship while the other aircraft. The Court is strained to understand the differences afforded these two modes of interstate commerce that warrant one form to receive use tax relief with respect to "provisions, supplies, maintenance and repairs" while the other is not.

I, too, am strained to understand the difference. Defendant at argument offered that perhaps airports put a strain on state resources in terms of connecting highways and such. I had thought that there were significant

federal subsidies for such highways to alleviate the burden on state resources, but in any event, do not dock facilities for the loading and unloading of waterborne cargo and its accompanying land transportation to its ultimate markets also place such burdens on highways and other infrastructures? As to which places the greater burden would likely, in my view, be measured in cargo tonnage loaded and unloaded – a figure of which this Court knows little – and, with all due deference, was, I suspect, far from the legislative mind.

A legislative intent to foster the shipping industry is propounded. Perhaps, but why was the shipping industry entitled to such state fostering over the interstate air freight industry? Self-evident reasons do not jump out. And why is the interstate air freight industry now being fostered through subsequent legislation which temporarily has abrogated the tax? If there were an explicit legislative finding on these issues, I would defer to any such remotely rational finding. In the absence of such, I can only conclude that when it comes to equal protection in this taxation scheme, the rational basis test gives way to Orwellian analysis, wherein all of the similarly situated are equal, but some of the similarly situated are more equal than others. In my view there is an equal protection violation here. *Williams v Vermont*, 472 US 14, 22; 105 S Ct 2465; 86 L Ed 2d 11 (1865); *Allegheny Pittsburgh Coal Co v Co Comm of Webster Co*, 488 US 336; 109 S Ct 633; 102 L Ed 2d 688 (1989); *Racchus Imports Ltd v Dias*, 468 US 263; 104 S Ct 3049; 82 L Ed 2d 200 (1984). See also *MCI Telecomm Corp v Dep't of Treasury*, 136 Mich App 38; 355 NW2d 627 (1984).

In the absence of any legislative finding, the proffered "rational basis" for the legislative exemption for the maintenance and repair of ships of 500 tons or more, but not for air freight haulers, strike me not as genuine rational reasons, but as mere pillows held up by defendant to absorb the attack of plaintiff, until plaintiff, in frustration and exhaustion, ultimately submits.

If there is a rational basis for the unequal use tax treatment here, it wholly escapes me. I would affirm.

/s/ James M. Batzer

Court of Appeals, State of Michigan

ORDER

ZANTOP
INTERNATIONAL
AIRLINES v
DEPT OF TREASURY

Docket # 152381

L.C. # 91-13365-CM

E. Thomas Fitzgerald

Presiding Judge

Thomas J. Brennan
James M. Batzer

Judges

The Court orders that the motion for rehearing is DENIED.

Judge Batzer would grant rehearing.

A true copy entered and certified by Ella Williams, Chief Clerk, on

[SEAL] NOV 28 1995
Date

/s/ Ella Williams
Chief Clerk

APPENDIX

Michigan Supreme Court
Lansing, Michigan

ORDER
Entered: September 27, 1996

James H. Brickley
Chief Justice

105137

Charles L. Levin
Michael F. Cavanagh
Patricia J. Boyle
Dorothy Comstock Riley
Conrad L. Mallett, Jr.
Elizabeth A. Weaver
Justices

ZANTOP INTERNATIONAL AIRLINES, INC.,

Plaintiff-Appellant,

v

REVENUE DIVISION, MICHIGAN DEPARTMENT OF TREASURY,

Defendant-Appellee.

SC: 105137
COA: 152381
CC: 91-013365

On order of the Court, the application for leave to appeal is considered, and it is DENIED, because we are not persuaded that the questions presented should be reviewed by this Court.

60924
[SEAL]

I, CORBIN R. DAVIS, Clerk of the Michigan Supreme Court, certify that the foregoing is a true and complete copy of the order entered at the direction of the Court.

September 27, 1996
/s/ Jacqueline B. MacKinnon
Deputy Clerk

AMENDMENT XIV – CITIZENSHIP; PRIVILEGES AND IMMUNITIES; DUE PROCESS; EQUAL PROTECTION; APPORTIONMENT OF REPRESENTATION; DISQUALIFICATION OF OFFICERS; PUBLIC DEBT; ENFORCEMENT

Section 1. All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

Art. 1, § 2 **CONSTITUTION OF 1963**

§ 2. Equal protection; discrimination

Sec. 2. No person shall be denied the equal protection of the laws; nor shall any person be denied the enjoyment of his civil or political rights or be discriminated against in the exercise thereof because of religion, race, color or national origin. The legislature shall implement this section by appropriate legislation.

205.94. Exemptions

Sec. 4. The tax levied shall not apply to:

Commercial vessels of 500 tons or more, supplies, repairs

(k) A vessel designed for commercial use of registered tonnage of 500 tons or more, when produced upon special order of the purchaser, and bunker and galley fuel, provisions, supplies, maintenance, and repairs for the exclusive use of a vessel of 500 tons or more engaged in interstate commerce.

205.94 Exemptions

Sec. 4. The tax levied shall not apply to:

* * *

Storage, use, or consumption of aircraft

(x) The storage, use, or consumption of any aircraft owned or used by a domestic passenger air carrier operating under a certificate issued by the civil aeronautics board pursuant to section 401 of title IV of the federal aviation act of 1958, 49 U.S.C. 1371, if the aircraft is used primarily in the regularly scheduled commercial transport of passengers.

89-48. Interstate Versus Intrastate Rolling Stock

You inquire regarding the taxability of rolling stock purchased out of state and placed into interstate commerce outside of Michigan. The vehicles subsequently are converted to use in intrastate commerce in Michigan.

In *Complete Auto Transit, Inc. v. Charles R. Brady, Jr.*, 430 US 274 (1977), the United States Supreme Court rejected the view that the states cannot tax interstate commerce but did impose limits on state taxation of interstate commerce. In *Complete Auto Transit,* the Court determined that a state's tax would be constitutionally valid provided it meets the following four-prong test:

1. It applies to an activity with a substantial nexus within the taxing state,
2. it is fairly apportioned,
3. it does not discriminate against interstate commerce, and
4. it is fairly related to the services provided by the state.

Using the four prong test, the following conclusions can be made:

1. In the instant case, the taxpayer clearly has substantial nexus with Michigan due to its intrastate trucking activity.
2. The Michigan use tax is fairly apportioned. No other state will tax the vehicles as the use is entirely within Michigan.
3. The Michigan use tax does not discriminate against interstate commerce because the property has become a part of the mass of property within this state.

4. The taxpayer receives the benefits of services such as police and fire protection, and particularly use of the roads in this state.

It appears that all four prongs of the *Complete Auto Transit* test are satisfied under the facts you present. Therefore, it is the Department's position that rolling stock purchased and placed into interstate commerce in another state but subsequently converted to intrastate commerce in Michigan is subject to use tax at the time of conversion. See MCL 205.91 et seq.

August 15, 1989
LR 89-48

Louis W. Duncan
Acting Commissioner of Revenue

LEGISLATIVE HISTORY OF MICHIGAN USE TAX ACT ("UTA") EXEMPTIONS FOR INSTRUMENTALITIES OF INTERSTATE COMMERCE

The §4(k) exemption for certain water vessels was adopted by the Michigan Legislature in 1949 [1949 Public Act 273 (effective July 1, 1949)] and has undergone no substantive change since its original adoption. The §4(x) exemption is of more recent vintage. It was adopted by the Michigan Legislature in 1984 [1984 Public Act 288 (effective 12/20/84)] and has undergone significant recent revision.

Under the 1984 version of the UTA, the aircraft exemption was limited to aircraft owned or used by a domestic air carrier if the aircraft was used primarily in the *regularly scheduled* commercial transport of passengers. The First Analysis to House Bill 5801, which was prepared by the Michigan House of Representatives Legislative Analysis Section shortly before the adoption of Public Act 288 of 1984, reflects that the Michigan legislature recognized, at that time, that passenger air carriers not domiciled in the state of Michigan could exercise dominion over their aircraft within Michigan free of use tax as long as they remained in the stream of commerce or were placed in the stream of commerce prior to entering the state of Michigan. (See this App. 25) The 1984 legislation was introduced to accommodate one airline – Simmons – which was a Michigan airline that was required to take delivery of aircraft outside the state of Michigan and employ them in the interstate transport of commercial passengers prior to bringing the aircraft into the state in order to avoid paying Michigan's 4 percent use tax on the entire acquisition price of the aircraft. So,

since 1984, Michigan law has clearly recognized that the storage, use or consumption of *aircraft* used in the commercial transport of passengers is exempt from use tax.

Public Act 214 of 1994 then altered this exemption to: (i) include aircraft used in the transport of "air cargo" within its scope, and (ii) expand the scope of the passenger aircraft exemption. After Public Act 214 of 1994, the exemption read:

> The storage, use, or consumption of any aircraft owned or used by a domestic air carrier operating under a certificate issued by the United States Department of Transportation pursuant to §401 of Title IV of the Federal Aviation Act of 1958, Public Law 85-726, 49 U.S.C. Appx. 1371-1376 and 1377-1389, if the aircraft is used solely in the transport of air cargo or in the commercial transport of passengers.

Public Act 214 of 1994 was ordered to take immediate effect and was approved and filed June 23, 1994. The exemption for air carriers provided for in the Act was made retroactively effective to January 1, 1993. On August 3, 1994, a Second Analysis to Enrolled House Bill 5451 was prepared by the House Legislative Analysis Section. The analysis makes clear that the impetus for the adoption of Public Act 214 was to encourage Michigan airlines companies to use Michigan as a base from which to maintain, repair, or refurbish aircraft. The analysis notes that "[i]f planes that fly all over the world are taxed because they are worked on in Michigan, companies will base their planes elsewhere." The expansive scope intended by the Legislature in passage of Public Act 214 is further evidenced by the only argument identified

against the legislation in the House Legislative Analysis. there, it was said:

> Currently, the exemption applies to certain aircraft used in the "regularly scheduled commercial transport of passengers." The bill extends the exemption not only to aid cargo transports but also eliminates the expression "regularly scheduled," thus extending the exemption to other kinds of commercial passenger aircraft.

Thereafter, on December 13, 1994, Public Act 424 of 1994 was approved and made effective January 6, 1995. Basically, Public Act 424 of 1994 continued the exemption for storage, use or consumption by a domestic air carrier of an aircraft purchased after December 31, 1992 for use in the transport of air cargo. The legislation modified, however, the longstanding exemption for aircraft used by domestic air carriers in the transport of passengers. Essentially, the legislation divided the passenger aircraft exemption into two parts – one for aircraft used solely in the "regularly scheduled transport of passengers" and the other for aircraft having a maximum certified takeoff weight of at least 12,500 pounds that is designed to have a maximum passenger seating configuration of more than 30 seats and is used to transport passengers. These two parts were not, however, made immediately effective. Rather, these exemptions apply to aircraft purchased after June 30, 1994 and after December 31, 1994, respectively.

In 1992 the Michigan Legislature extended the aircraft exemptions described above to certain parts and materials affixed in the state of Michigan to an aircraft owned or used by a domestic air carrier. 1992 Public Act 5

(effective February 27, 1992). M.C.L. 205.94k. This section was amended in 1995 and now reads:

> Sec. 4k (1) The tax levied under this act does not apply to parts and materials, excluding shop equipment or fuel, affixed to or to be affixed in this state to an aircraft owned or used by a domestic air carrier that is any of the following:
>
> (a) An aircraft purchased after December 31, 1992 for use solely in the transport of air cargo that has a maximum certificated takeoff weight of at least 12,500 pounds.
>
> (b) An aircraft purchased after June 30, 1994 that is used solely in the regularly scheduled transport of passengers.
>
> (2) For purposes of this section, "domestic air carrier" is limited to entities engaged in the commercial transport for hire of cargo or entities engaged in the commercial transport of passengers as a business activity.
>
> (3) This section does not apply after December 31, 1996.

[LOGO] House Legislative Analysis Section
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NO USE TAX ON SIMMONS AIRCRAFT

HOUSE BILL 5801 with committee amendments First Analysis (11-20-84)

Sponsor: Rep. Dominic Jacobetti
Committee: Taxation

THE APPARENT PROBLEM:

Due to the vagaries of federal and state laws, an airline must pay the Michigan use tax on its aircraft only if it introduces the planes into service here. Simmons is the only regularly scheduled interstate airline whose headquarters are in Michigan, and prepares its planes for service in Marquette. In order to avoid being the only airline in the country liable for the Michigan use tax, Simmons must undergo the inconvenience and expense of flying its new planes from company headquarters to an airport outside the state for introduction into interstate service. The company suggests that requiring it to pay the tax when no other airline must is unfair to a Michigan business, and discourages the establishment of other airlines here.

THE CONTENT OF THE BILL:

The bill would exempt from the use tax the storage, use, or consumption of any aircraft owned or used by a domestic passenger carrier operating under a certificate issued by the Civil Aeronautics Board if the aircraft is

used primarily in the regularly scheduled commercial transportation of passengers.

FISCAL IMPLICATIONS:

According to the Department of Treasury, the bill would cost the state nothing, since Simmons already avoids the tax by introducing its planes into service outside the state.

ARGUMENTS:

For:

The bill would, be exempting aircraft used by regularly scheduled airlines from the use tax, remove potential liability and present inconvenience for Simmons Airlines and encourage the establishing of other commercial carriers in Michigan.

POSITIONS:

Simmons Airlines supports the bill. (11-14-84)

The Department of Treasury does not oppose the bill. (11-14-84)

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House Bill 5451 (8-3-94)

AIRCRAFT USE TAX EXEMPTION
P.A. 214 of 1994

House Bill 5451 as enrolled
Second Analysis (8-3-94)

Sponsor: Rep. Kirk A. Profit
House Committee: Taxation
Senate Committee: Not Referred

THE APPARENT PROBLEM:

The Use Tax Act currently provides an exemption for certain commercial aircraft purchased elsewhere and introduced into use in the state. The exemption applies to aircraft owned or used by a domestic passenger air carrier and used in the regularly scheduled commercial transport of passengers, if certain federal certificates are obtained. (Tax specialists say the certificates are those acquired for larger planes, holding 60 or more passengers or 17,000 pounds or more of cargo, that are engaged in interstate commerce.) Otherwise, aircraft purchased outside the state and brought into the state are subject to the tax. Representatives of a rapidly growing Michigan cargo (and charter passenger) carrier based at Willow Run, American International Airways, has asked that the exemption be extended to their aircraft. Testimony before the House Taxation Committee indicated that the applicability of the tax to the company's aircraft which fly all over the world but are maintained in this state, came to

light as a result of a state tax audit. Representatives of the company told the committee that the company, whose customers include the overnight package industry, the U.S. Postal Service, and the U.S. military, is expected to have 2,000 employees by the end of the year, up from 500 in 1990. Company spokesman say they intend to purchase in the near future over $90 million of aircraft that will be converted from passenger to freight uses at a maintenance facility in Oscoda. This will result in a $5.4 million state use tax liability, a tax burden that could be avoided if the company refurbished the planes in one of 25 other states that exempt such aircraft.

THE CONTENT OF THE BILL:

The bill would amend the Use Tax Act (MCL 205.94) to expand the aircraft exemption so that it applies to the storage, use, or consumption of any aircraft owned or used by a domestic air carrier operating under a certificate issued by the U.S. Department of Transportation, if the aircraft was used solely in the transport of air cargo or in the commercial transport of passengers. The exemption for air carriers would be effective beginning January 1, 1993.

FISCAL IMPLICATIONS:

There is no specific information at present. The Department of Treasury testimony before the House Taxation Committee (5-18-94) indicated that the state would lose revenue as a result of the bill if its provisions remained retroactive to 1989; some carriers not previously exempt have paid use taxes to the state that would have to be

refunded. As enacted, however, the exemption extends back only to 1993.

ARGUMENTS:

For:

The bill would extend a current use tax exemption for passenger aircraft to, among others, a Michigan-based company that flies packages (and also passengers) all over the world in planes maintained at Willow Run and Oscoda. This is a company that is said to have added over 1,000 jobs in the past four years and expects continued job growth this year. Without this bill, the company will face a significant use tax bill from the state as a result of a recent state audit. The company's plan to refurbish some $90 million worth of aircraft this summer will cost them over $5 million in taxes. These taxes could be avoided by moving the work to a state where such aircraft are exempt. This is not a tax that the company has been paying to the state, so there would be no loss of anticipated state revenue as a result of the bill's passage. As the law stands now, it discourages companies from using Michigan as a base from which to maintain, repair, or refurbish aircraft. If planes that fly all over the world are taxed because they are worked on in Michigan, companies will base their planes elsewhere.

Response:

It should be noted that an earlier version of the bill would have made the exemption retroactive to 1989, which would have provided greater benefit to the air transport industry.

Against:

Currently, the exemption applies to certain aircraft used in the "regularly scheduled commercial transport of passengers." The bill extends the exemption not only to air cargo transports but also eliminates the expression "regularly scheduled," thus extending the exemption to other kinds of commercial passenger aircraft.